

Legislative Audit Division

State of Montana



Report to the Legislature

March 1998

Financial-Compliance Audit

Montana State University

All campuses

For the Two Fiscal Years Ended June 30, 1997

This report contains 13 recommendations directed to the university. These recommendations address issues related to:

- ▶ Cash controls.
- ▶ Procurement procedures.
- ▶ Recognizing expenditures.
- ▶ Bond reserves.

Direct comments/inquiries to:
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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act of 1984, and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1997 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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March 1998

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on Montana State University-Bozeman, including the College of Technology-Great Falls (formerly known as the Great Falls Vocational-Technical Center); Montana State University-Billings, including the College of Technology (formerly known as the Billings Vocational-Technical Center); and Montana State University-Northern for fiscal years 1995-96 and 1996-97. The results of audit work on these three campuses have been combined in one document at the request of Montana State University management.

The report recommendations are addressed to Montana State University but relate to specific campuses. This report includes recommendations regarding cash controls, state and federal legal compliance, and complete and accurate recording of assets and financial activity.

The university's written response to the audit recommendations is included at the end of this report.

We thank the president, chancellors, and their staffs for their cooperation and assistance throughout the audit.

Respectfully submitted,

"Signature on File"

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Financial-Compliance Audit

Montana State University

All campuses

For the Two Fiscal Years Ended June 30, 1997

Members of the audit staff involved in this audit were Pearl Allen, Jody Brandt, Chris Darragh, Laurie Evans, John B. Fine, Geri Hoffman, Frieda Houser, Scott Hoversland, Wayne Kedish, Susan McEachern, Vickie Murphy, Charles Nemec, Paul J. O'Loughlin and Vickie Rauser.

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Appointed and Administrative Officials

Board of Regents of Higher Education		Term <u>Expires</u>
	Jim Kaze, Chairman	Havre 1999
	Paul Boylan	Bozeman 1998
	L. Colleen Conroy	Hardin 2001
	Patrick P. Davison	Billings 2000
	Mike Green, Student Regent	Belgrade 1998
	Edwin H. Jasmin	Big Fork 2004
	Margie Thompson	Butte 2003
	Marc Racicot, Governor*	
	Nancy Keenan, Superintendent of Public Instruction*	
	*Ex officio members	
Commissioner of Higher Education	Richard Crofts, Commissioner of Higher Education Stuart Knapp, Deputy Commissioner for Academic Affairs Rod Sundsted, Associate Commissioner for Fiscal Affairs Laurie Neils, Director of Budget and Accounting LeRoy Schramm, Chief Legal Counsel	
Montana State University-Bozeman	Michael Malone, President Joseph Chapman, Provost and Vice President for Academic Affairs Robert Specter, Vice President for Administration and Finance Robert Swenson, Vice President for Research and Creative Activities Leslie Taylor, Legal Counsel Dianna Wojtowicz, Controller Allen Yarnell, Vice Provost for Academic Affairs	
Montana State University-Billings	Ronald Sexton, Chancellor Janie Park, Provost and Academic Vice Chancellor David Mathieu, Dean of Academic and Student Support Terrie Iverson, Administrative Vice Chancellor LeAnn Anderson, Director of Financial Services Jim Nielson, Director of Business Services Trudy Collins, Budget Officer	
Montana State University-Northern	William Daehling, Chancellor Karen LaRoe, Vice Chancellor for Academic Affairs Carl Ellis, Vice Chancellor for Student Affairs and Administration William Byars, Director of Budget William O'Donnell, Controller	

Report Summary

Montana State University All Campuses

This financial-compliance audit report contains the results of our audit of the Montana State University campuses for the two fiscal years ended June 30, 1997. The report contains 13 recommendations where Montana State University (university) could enhance compliance with federal regulations and state law and policies.

We issued unqualified opinions on the financial statements for Montana State University-Bozeman, Montana State University-Billings, and Montana State University-Northern for fiscal years 1995-96 and 1996-97. This means the reader may rely on the presented financial information.

The listing below serves as a means of summarizing the recommendations contained in the report, the university's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the university strengthen internal controls by segregating incompatible cash custody and record keeping functions and by instituting additional supervision and review processes. 12

University Response: Concur. See page D-4.

Recommendation #2

We recommend the university comply with state law regarding deposits and change funds. 13

University Response: Concur. See page D-4.

Recommendation #3

We recommend the university:

- A. Maintain accountability for university assets managed by RDI.

University Response: Concur. See page D-4.

- B. Ensure RDI complies with the contract requirement concerning providing the university with financial statements and a CPA's report verifying their accuracy. . . . 14

University Response: Concur. See page D-4.

Report Summary

<u>Recommendation #4</u>	We recommend the university formalize all vendor contracts to include the provisions outlined in state policy. 15
	<u>University Response:</u> Concur. See page D-5.
<u>Recommendation #5</u>	We recommend the university obtain Board of Regents approval, if it is necessary, to allow the bond trustee to hold bond reserves in addition to the \$1.5 million bond indenture requirement. 16
	<u>University Response:</u> Concur. See page D-5.
<u>Recommendation #6</u>	We recommend the university:
	A. Recover indirect costs to the fullest extent possible in accordance with state law.
	<u>University Response:</u> Concur. See page D-5.
	B. Negotiate an indirect cost rate with the federal government. 17
	<u>University Response:</u> Concur. See page D-5.
<u>Recommendation #7</u>	We recommend the university complete grant billings on a timely basis. 17
	<u>University Response:</u> Concur. See page D-6.
<u>Recommendation #8</u>	We recommend the university record transfers on the accounting records and financial statements in accordance with generally accepted accounting principles as required by state law. 19
	<u>University Response:</u> Concur. See page D-6.
<u>Recommendation #9</u>	We recommend the university:
	A. Record abatements only for those transactions allowed by state policy.
	<u>University Response:</u> Concur. See page D-6.

- B. Develop an internal policy on expenditure abatements and provide training on its requirements to all department personnel. 20

University Response: Concur. See page D-6.

Recommendation #10

We recommend the university accrue expenditure transactions at fiscal year-end in accordance with state accounting policy. 21

University Response: Concur. See page D-7.

Recommendation #11

We recommend the university complete a reconciliation of the Financial Reporting System detail and summary financial information at fiscal year-end and resolve any differences. 22

University Response: Concur. See page D-7.

Recommendation #12

We recommend the university establish a system:

- A. To compare employee's certification of actual time spent on grants with charges to grants on SBAS and make appropriate adjustments on SBAS.

University Response: Concur. See page D-7.

- B. That ensures charges to grants are based upon certified time and effort reports at its Northern campus. 24

University Response: Concur. See page D-7.

Recommendation #13

We recommend the university develop procedures to ensure Pell Grant payments are disbursed in accordance with federal regulations. 24

University Response: Concur. See page D-8.

Introduction

Audit Objectives

We performed a financial-compliance audit of Montana State University (MSU), all campuses (the university) for the two fiscal years ended June 30, 1997. The objectives of the audit were to:

1. Determine if the university complied with applicable laws and regulations.
2. Make recommendations for improvements in the internal and management controls of the university.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the financial statements present fairly the financial position and results of operations of each university campus for the two fiscal years ended June 30, 1997.

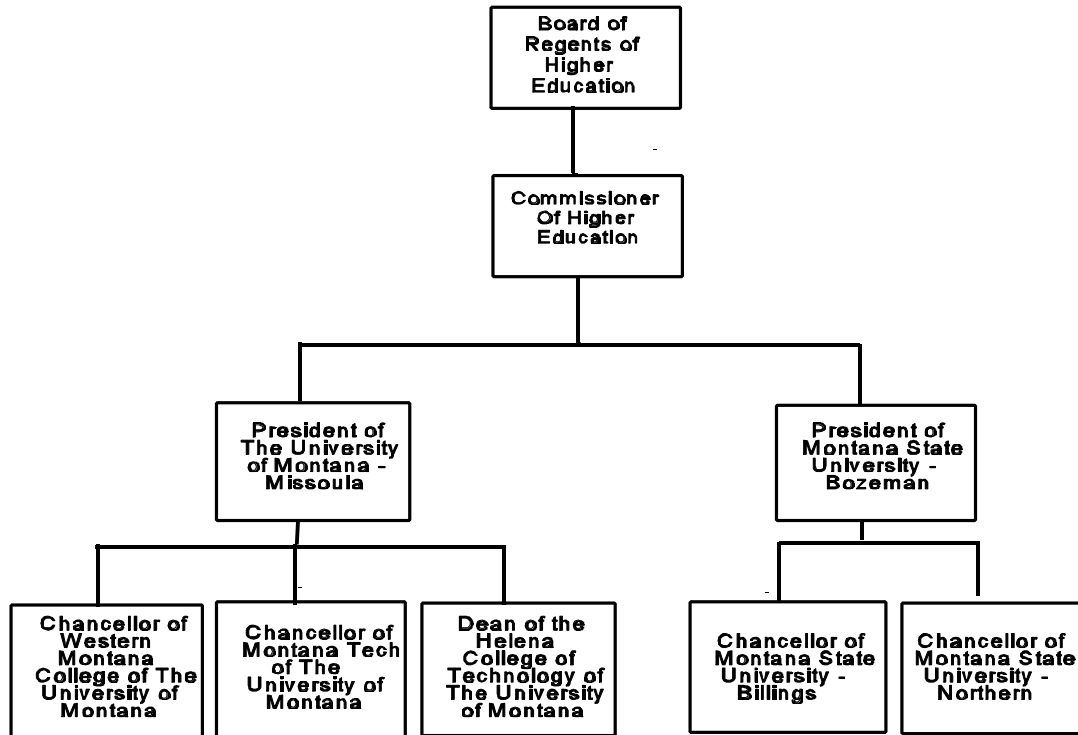
In accordance with section 5-13-307, MCA, we analyzed the costs of implementing the recommendations made in this report. Each report section discloses the cost, if significant, of implementing the recommendation. Other areas of concern deemed not to have a significant effect on the successful operation of university programs are not specifically included in the report, but have been discussed with management.

Background

The Board of Regents of Higher Education approved the restructuring of the Montana University System in January 1994. The following chart documents the organization of the entire Montana University System during our audit period.

Figure 1

Montana University System Organizational Chart



Source: Compiled by the Legislative Audit Division from university information.

Montana State University

Montana State University consists of the following three campuses:

- MSU-Bozeman, includes the Bozeman campus, the Agricultural Experiment Station and the Extension Service. Facilities in Great Falls include the MSU College of Technology-Great Falls (formerly known as the Great Falls Vocational-Technical Center) and the Fire Services Training School;
- MSU-Billings, including the College of Technology (formerly known as the Billings Vocational-Technical Center); and
- MSU-Northern at Havre and Great Falls.

These campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges. MSU's three campuses provide a diversity of undergraduate and graduate academic and vocational/technical programs to students, as described below.

Montana State University-Bozeman

The MSU-Bozeman campus was founded in February 1893 as the Agricultural College of the state of Montana. The university is a land-grant institution, authorized by the Morrill Act of 1862, and receives part of its support from land-grant income. The campus offers instruction leading to bachelor, master, and doctorate degrees. Its professional programs include: agriculture, home economics, motion picture/video production and photography, and architecture.

The MSU College of Technology-Great Falls offers instruction leading to certificates in one year programs and associate of applied science degrees in two year programs in vocational-technical trades and industry. Programs include practical nursing, office/secretarial, interior design technology, computer and information sciences, various health related programs, and business management/entrepreneurship.

MSU-Bozeman's public service function originated with the establishment of the Extension Service in 1915, and was created under the federal Smith-Lever Act and state legislation. Financial support for the Extension Service's operation comes from county, state, and federal governments, as well as from private grants.

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County agents and specialists are an integral part of the university and channel information to Montanans to aid in solving home, farm, and community problems. In January 1990, administrative control of the Fire Services Training School, located in Great Falls, was transferred from the Board of Public Education to the university's Extension Service.

The Agricultural Experiment Station is also an integral part of the university. It was established in 1893 by the Montana Legislature under authorization provided by the federal Hatch Act of 1887. The station receives federal funds under the Hatch Act, as well as state appropriations, federal and private grants, and funds from the sale of surplus agricultural products. The Agricultural Experiment Station has eight locations in the state, in addition to the Bozeman campus. These research stations are devoted to solving agricultural and land reclamation problems of local, regional, and national concern. The distribution of research centers allows consideration of problems peculiar to various soil, water, and climate conditions in the state.

The university has several other specialized research facilities on the Bozeman campus. These include the Engineering Experiment Station, the Statistical Center, the Water Resource Center, the Center for Biofilm Engineering and the Mountain Research Center.

The university offers educational opportunities through its Extended Studies program to individuals not regularly enrolled. An annual summer session and certain specialty oriented, non-credit offerings are also part of the campus program. The Museum of the Rockies, a nonprofit corporation affiliated with the university, provides educational opportunities, particularly for school age children.

Montana State University-Billings

Montana State University-Billings (formerly Eastern Montana College) was established in Billings, Montana by the Legislative Assembly on March 12, 1927, with an initial authorization to prepare teachers for the elementary schools. Statutory authority for Montana State University-Billings is contained in Title 20, chapter 25, MCA. The University was initially called Eastern Montana State Normal School at Billings and was established to prepare teachers for elementary schools in eastern Montana. The name was

changed to Eastern Montana College of Education in 1949, then to Eastern Montana College in 1965.

In January of 1994, the Montana University System Board of Regents approved the restructuring of the Montana University System. As part of that restructuring, effective July 1, 1994, Montana State University-Bozeman was given administrative oversight of Eastern Montana College and the name of the institution was changed to Montana State University-Billings (MSU-Billings). In addition, the Billings Vocational-Technical Center was fully merged into MSU-Billings and renamed MSU-Billings College of Technology.

MSU-Billings has grown, with the city of Billings and Yellowstone County, into the major higher education center of south central Montana. The University consists of five colleges: the College of Arts and Sciences; the College of Business; the College of Education and Human Services; the College of Technology; and the college of Professional Studies and Lifelong Learning.

MSU-Billings offers a full complement of one and two year certificate programs, associate degrees, and bachelor and master degrees, as well as pre-professional academic offerings in a number of fields. Several academic programs are unique to the Montana University System.

MSU-Billings is fully accredited by the Northwest Association of Schools and Colleges. It is accredited by the National Council for the Accreditation of Teacher Education for preparing elementary and secondary teachers through the Master of Education degree and the Master of Science in Special Education degree. MSU-Billings is also accredited by the National Association of Schools of Music, the National Association of Schools of Art and Design, and the Council on Rehabilitation Education. College of Technology programs are approved by the National Institute for Automotive Service Excellence and the Montana Board of Nursing.

Public service is integral to the mission of the university. Its two primary public service entities are KEMC Public Radio and the

Introduction

Montana Center on Disabilities, a comprehensive education, rehabilitation, and diagnostic center serving Montana's individuals with disabilities.

Montana State University-Northern

The MSU-Northern campus opened for instruction in September 1929 as Northern Montana College. MSU-Northern is a regional, multi-purpose educational center serving students who seek both a technical and liberal arts education. MSU-Northern offers programs at the associate, baccalaureate, and master degree levels. A master's program is offered in education, with options in counseling and development, elementary education, vocational education, and general science. Graduate education includes a fifth-year program for elementary and secondary teachers.

MSU-Northern offers courses at two locations, the campus in Havre and an extended campus in Great Falls, as well as long-distance learning via compressed, interactive video. MSU-Northern at Great Falls includes an environmental training center.

Full-Time Equivalent Faculty and Students

The four MSU campuses reported actual employee FTE (full-time equivalent positions) of 3118 for fiscal year 1997. Contract faculty positions totaled 951 which include part-time, visiting, and full-time teaching faculty, and state supported research faculty.

The following table lists full-time equivalent students by campus.

Table 1

Montana State University
Annual Student FTE by Campus

<u>Campus</u>	<u>Fiscal Year</u>		
	<u>1995</u>	<u>1996</u>	<u>1997</u>
MSU-Bozeman			
Resident	8,167	8,291	8,293
Nonresident	<u>2,541</u>	<u>2,722</u>	<u>2,770</u>
Total	<u>10,708</u>	<u>11,013</u>	<u>11,063</u>
MSU-Billings			
Resident	3,431	3,455	3,463
Nonresident	<u>234</u>	<u>257</u>	<u>218</u>
Total	<u>3,665</u>	<u>3,712</u>	<u>3,681</u>
MSU-Northern			
Resident	1,582	1,436	1,416
Nonresident	<u>73</u>	<u>58</u>	<u>84</u>
Total	<u>1,655</u>	<u>1,494</u>	<u>1,500</u>
Grand Totals MSU			
Resident	13,180	13,182	13,172
Nonresident	<u>2,848</u>	<u>3,037</u>	<u>3,072</u>
Total FTE	<u>16,028</u>	<u>16,219</u>	<u>16,244</u>

Source: Compiled by the Legislative Audit Division from university information.

Funding Sources

University system Current Unrestricted General Operating Subfunds revenues include state general fund, millage, and tuition and fees, which are specifically appropriated by the legislature. Current Funds also include designated, auxiliary and restricted activity. General Fund and millage appropriations to Montana State University are based upon the anticipated number of resident students and the cost of educating students. The appropriation support is based upon an analysis of faculty salaries in states with similar per capita income, the academic program offerings of the university, the necessary support expenditures, including Academic

Introduction

Support, Student Services, Institutional Support, Plant Operating and Maintenance, and the proportion of the cost of education to be paid by resident students.

General Fund and millage appropriations are dedicated to the support of resident students only. Resident students on a four-year campus pay approximately 33 percent of the cost of education, while resident students on the two-year campuses pay approximately 30 percent of the cost of education. Non-resident students on a four-year campus are required to pay at least 100 percent of the cost of education. Non-resident students on a two-year campus paid approximately 70 percent of the cost of education in fiscal year 1995-96.

Prior Audit Recommendations

Prior Audit Recommendations

Our office performed financial-compliance audits of MSU-Bozeman, MSU-Northern, and MSU-Billings College of Technology for the two fiscal years ending June 30, 1995 and of MSU-Billings for the fiscal year ending June 30, 1995. The resulting report contained five recommendations for MSU-Bozeman, eight recommendations for MSU-Northern, and no recommendations for MSU-Billings and its College of Technology.

Of the five recommendations for MSU-Bozeman, four were implemented and one was not implemented. The recommendation which was not implemented relates to noncompliance with state and university policy for expenditure abatements and is discussed on page 19.

Of the eight recommendations for MSU-Northern, four were implemented and four were partially implemented. Three of the partially implemented recommendations related to controls over cash (segregation of duties, compliance with state accounting law and policy regarding imprest cash accounts, and timely deposits) and are discussed on page 12. The fourth partially implemented recommendation concerned MSU-Northern's financial activity not being recorded on the state's accounting system in the appropriate account, program, and classification in accordance with state law. Revenue classification errors and unrecorded expenditures of immaterial amounts have been discussed with MSU-Northern management and did not result in report recommendations.

Findings and Recommendations

Improving Controls Over Collections and Non-Treasury Cash Accounts

MSU's responsibilities include establishing and maintaining adequate systems of internal control. An internal control system should provide management with reasonable, but not absolute, assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded; and reliable data is obtained, maintained, and disclosed. Because of inherent limitations in any internal control system, errors or irregularities may occur and not be detected. However, a good system of internal control reduces the risk of such errors or irregularities.

We obtained an understanding of the various control systems and reviewed several cash collection points on MSU campuses. The following sections discuss areas where internal controls and accountability for revenue collections and non-treasury cash accounts, as well as compliance with related state law and policies, could be improved.

Health Service Cash Collections

We worked with the university's internal auditor and the Department of Justice's Criminal Investigation Bureau to document a situation where an individual allegedly embezzled funds from the university's student health service. The internal auditor estimated \$757,642 was taken. Weaknesses in the university's cash collection and deposit process allowed the alleged theft to occur and remain undetected for approximately ten years.

At the health services, one individual had control over the cash collection, deposit preparation and cash receipting processes. Segregating the duties of recording daily sales of services on the university accounting system from cash collection and deposit duties and an independent comparison of daily deposits to daily sales could have detected shortages in sales deposits. In addition, the university did not review the reasonableness of the proportions of cash, checks and credit card receipts included in health service deposits. Reviewing the composition of deposits can involve comparing the percentage of currency, checks, and credit sales in an entity's daily deposit to what management's analysis of the business activity indicates should be deposited. State policy requires all state agencies to maintain adequate controls over cash and other financial

Findings and Recommendations

activities. This matter has been referred to the Attorney General as required by state law.

Satellite Campus - Segregation of Duties

In our prior audit, we recommended MSU-Northern adequately segregate duties of its Great Falls campus personnel responsible for record keeping and custodianship of cash. We found MSU-Northern initially hired an individual to provide the opportunity to segregate these duties, but due to a decrease in tuition and fee revenue, was unable to continue funding the position. As a result, MSU-Northern has one person handling all these duties at the Great Falls campus.

If MSU-Northern cannot appropriately segregate incompatible duties at the Great Falls campus, then officials at the Havre campus should strengthen their supervision and review process to mitigate the lack of segregation of duties.

Subsequent to our audit, university officials told us they had implemented additional controls through the use of armored car courier services, and by having Havre campus staff perform student fee analyses for Great Falls campus students.

Recommendation #1

We recommend the university strengthen internal controls by segregating incompatible cash custody and record keeping functions and by instituting additional supervision and review processes.

Timely Deposit

State law requires all money be deposited each day when the accumulated coin and currency requiring deposit exceeds \$100, total collections exceed \$500, or at least weekly. We noted the following situations where MSU campuses did not comply with this law, increasing the risk of theft or loss and, in some cases, causing financial activity to be recorded in the wrong fiscal year.

- At MSU-Northern's Student Health Service we noted \$70 of collections that were more than a week old and had not been deposited at the time of our review. The checks were not

Findings and Recommendations

restrictively endorsed as required by state policy. We also noted a health service deposit of \$869.31 made on March 4, 1997, which was an accumulation of collections since December 16, 1996.

- MSU-Bozeman's Business Office personnel do not deposit reimbursements of travel advances until an accounting technician reviews the related travel expense vouchers which can delay deposit. In addition, if the review indicates the reimbursement is incorrect, additional deposit delays can occur.

Cash Change Funds

State law requires agencies to get approval from the Department of Administration for cash change funds. The amount of the cash change funds should agree to the authorized amounts and should never be used to make purchases.

- At MSU-Northern we noted one instance where an existing cash change fund was not authorized or recorded on MSU-Northern's accounting records. Also, the amount of cash held in another MSU-Northern's change fund exceeded the authorized amount. At MSU-Billings we found the authorized amount for one cash change fund exceeded the amount of cash on hand.

Recommendation #2

We recommend the university comply with state law regarding deposits and change funds.

Patents and Licenses

The Research and Development Institute (RDI) is a nonprofit corporation established in 1980 to serve as the MSU-Bozeman patent development and licensing management organization. Based on an agreement between the MSU-Bozeman and RDI, the university assigns new inventions to RDI for patent development and licensing. Under the agreement, RDI deducts direct expenses and 10 percent for indirect expenses. After these deductions, the agreement states 50 percent of the patent and royalty revenue will remain in an account at RDI to support MSU-Bozeman research, and 50 percent will be distributed to the inventor.

Findings and Recommendations

According to our review of the agreement and discussions with university and RDI officials, the 50 percent which remains in the RDI account to support research belongs to MSU-Bozeman. RDI reports to MSU-Bozeman indicate that RDI held \$66,511 of MSU-Bozeman funds at June 30, 1997 and made \$86,992 in grants from the funds in calendar year 1997. The university does not account for its share of the patent and royalty assets, expenditures, and revenue on the state's accounting records as required by state law. Section 17-1-102(4) MCA, requires all state agencies, including university units, maintain accountability for all their financial resources on the state's accounting records.

The university does not adequately monitor the financial activity of RDI. MSU-Bozeman has an obligation to monitor RDI's financial activity even though it contracted with RDI to manage patent finances. Also, the written agreement between RDI and MSU-Bozeman requires RDI to provide MSU-Bozeman with financial statements, prepared in accordance with generally accepted accounting principles, and a report verifying the accuracy of the statements prepared by an independent Certified Public Accountant (CPA). MSU-Bozeman provided us with a letter from the CPA outlining agreed upon procedures performed on RDI 1996 financial information. However, the financial information provided did not constitute financial statements prepared in accordance with generally accepted accounting principles. In addition, the CPA did not verify the accuracy of financial statements as required by MSU-Bozeman's contract with RDI.

Recommendation #3

We recommend the university:

- A. Maintain accountability for university assets managed by RDI.
- B. Ensure RDI complies with the contract requirement concerning providing the university with financial statements and a CPA's report verifying their accuracy.

Findings and Recommendations

Vendor Agreements

During our audit, we noted two vendors who pay the university a sponsorship fee for the right to sell food at athletic events. In addition to the sponsorship fee, one vendor gives MSU-Bozeman's athletic department a percent of gross sales and free product. MSU does not have detailed written contracts with these vendors.

Good business practice dictates a written contract setting forth the rights and duties of the parties involved. State law requires agreements address workers' compensation insurance and access to records. State policy provides examples of additional items such as termination clauses, venue, indemnity and other provisions be included in agreements. The existing agreements do not address workers' compensation insurance or access to records.

Recommendation #4

We recommend the university formalize all vendor contracts to include the provisions outlined in state policy.

Excess Bond Reserve Moneys

Section 17-6-105, MCA, requires the university to deposit all funds in the state treasury unless otherwise directed by a bond indenture or other legal requirement. The 1993 master bond indenture requires the university to establish a Repair and Replacement Fund of not less than \$1.5 million, which is required to be held and invested by the bond trustee. As of May 1, 1997, the reserves in the fund held by the bond trustee totaled \$2,379,196.

MSU-Bozeman personnel indicated the indenture was written with a "minimum" balance so that they would not be required to pull the additional amounts out and deposit it in the university accounts in the state treasury. Under the terms of the indenture, the amount required in the Repair and Replacement Fund is \$1.5 million unless action is taken by the Board of Regents authorizing an increased amount. If the board takes no formal action to increase the amount, any moneys in the Repair and Replacement Fund in excess of \$1.5 million are required by law to be deposited in the university accounts in the state treasury.

Findings and Recommendations

Recommendation #5

We recommend the university obtain Board of Regents approval, if it is necessary, to allow the bond trustee to hold bond reserves in addition to the \$1.5 million bond indenture requirement.

Recovery of Indirect Costs

Section 17-3-111, MCA, requires agencies to recover indirect costs of federal assistance programs to the fullest extent possible. In addition, Board of Regents' policy requires units of the Montana University System to recover federal indirect costs in accordance with the university's federally approved rate.

We noted MSU-Northern did not recover indirect costs on a U.S. Environmental Protection Agency (EPA) grant in fiscal year 1995-96. We also noted MSU-Northern only requested 15 percent administrative costs on a grant from U.S. Department of Labor which allowed for a maximum of 20 percent administrative costs. MSU - Northern's approved rate was sufficient in fiscal year 1995-96 to have charged the full 20 percent.

MSU-Northern personnel stated they did not believe EPA paid indirect costs on its grants, however, they could not provide support indicating indirect costs were not allowed. MSU-Northern personnel indicated they did not recover the full 20 percent administrative costs on the U.S. Department of Labor grant since it would have reduced the funds available for the program.

We also noted MSU-Northern's approved negotiated indirect cost rate expired June 30, 1996 and they did not have an approved indirect cost rate in fiscal year 1996-97. MSU-Northern personnel stated the federal government would provide a provisional rate, if one was needed.

Findings and Recommendations

Recommendation #6

We recommend the university:

- A. Recover indirect costs to the fullest extent possible in accordance with state law.
- B. Negotiate an indirect cost rate with the federal government.

Cash Management

The majority of the MSU-Bozeman's grants are funded on a reimbursement basis. MSU-Bozeman's Grants and Contracts Office has established procedures to draw cash for its reimbursement grants on a monthly basis. In May 1997, we noted the office had not requested \$219,790 for five grants from the U.S. Department of Defense. These costs had been outstanding since January 1997. Grants and Contracts personnel stated they had not had time to request these funds because of their workload. By not requesting federal funds in a timely manner, state funds are used until the federal funds are received. We estimate lost interest of \$4,200 for the four-month delay in requesting these funds. Effective cash management require timely requests of federal funds in order to minimize the time period state funds are used to cover federal costs.

Recommendation #7

We recommend the university complete grant billings on a timely basis.

Accounting Records

The university records financial information on the Statewide Budgeting and Accounting System (SBAS) as well as its own financial record keeping system. State law requires transactions entered on SBAS be recorded in accordance with Generally Accepted Accounting Principles (GAAP). The Department of Administration, Accounting Bureau, has adopted state accounting policies to facilitate compliance with GAAP. In the following three sections, we discuss instances where the university did not record financial activity on SBAS in accordance with state law and accounting policy.

Findings and Recommendations

Transfers

We found three cases where MSU-Bozeman should have eliminated transfers within the same subfund or recorded transfers rather than expenditures when money was moved from one subfund to another.

- MSU-Bozeman moves funds between accounts within the same subfund using transfer control accounts to record the transactions. Since this activity is all within the same subfund it should not be recorded as transfers. When the controller prepares the financial statements of the university, this activity is eliminated; however, it is still recorded on SBAS. The intra-fund activity inappropriately recorded on the agency records as transfers was:

	Fiscal Year 1995-96	Fiscal Year 1996-97
Designated subfund	\$2,656,786	\$2,061,864
Unexpended Plant subfund	\$4,150,841	\$7,220,803
Renewal and Replacement subfund	\$ 0	\$ 106,376
Retirement of Indebtedness subfund	\$ 211,500	\$3,248,032

- MSU-Bozeman records movement of funds from the Current Restricted subfund to the Unexpended Plant subfund as an expenditure of the Current Restricted subfund and a revenue of the Unexpended Plant subfund. We noted approximately \$1,003,580 and \$1,497,097 of expenditures in the Current Restricted subfund in fiscal years 1995-96 and 1996-97, respectively, that should have been recorded as transfers. Revenues of the same amount were recorded in the university's Unexpended Plant subfund. University personnel noted they believed transfers-out were not appropriate in the Current Restricted subfund because of the restrictions on that money. Since the funds were used in the Unexpended Plant subfund for the acquisition of long-lived assets in accordance with the grant restrictions, the activity meets the objectives of the Unexpended Plant subfund and should be recorded as a transfer of funds from the Current Restricted subfund to the Unexpended Plant subfund rather than an expenditure/revenue transaction. These adjustments were not made on SBAS.
- MSU-Bozeman collects student fees and user charges to fund building construction and maintenance. These collections are passed from current funds to plant funds and recorded as expenditures and revenues, respectively. The amounts are reclassified as transfers-out of the current funds and transfers-in to the plant funds when MSU financial statements are prepared. This information is not adjusted on SBAS. The following

Findings and Recommendations

amounts should be recorded as transfers-out instead of expenditures on SBAS:

<u>Current Funds</u>	<u>Fiscal Year 1995-96</u>	<u>Fiscal Year 1996-97</u>
General Operating	\$593,480	\$1,490,697
Designated	\$ 45,467	\$ 181,190
Auxiliary	\$ 90,000	\$ 35,000

The following amounts should be recorded as transfers-in instead of revenues on SBAS.

<u>Plant Funds</u>	<u>Fiscal Year 1995-96</u>	<u>Fiscal Year 1996-97</u>
Unexpended	\$ 412,400	\$ 801,036
Renewal & Replacement	\$ 416,547	\$ 795,851
Debt Service	\$ 0	\$ 110,000

Based on this issue we reviewed other transactions and noted approximately \$965,000 and \$125,000 of additional revenue and expenditure activity in fiscal years 1995-96 and 1996-97, respectively, that should have been recorded as transfers-in and transfers-out on SBAS.

Recommendation #8

We recommend the university record transfers on the accounting records and financial statements in accordance with generally accepted accounting principles as required by state law.

Expenditure Abatements

Expenditure transactions record the use of resources by the university, while expenditure abatements cancel previously recorded expenditures. State accounting policy, Management Memo 2-94-2, allows the use of expenditure abatements to record a refund made to the state from an overpayment of a bill, or to record reimbursements of specific items incurred by an agency which are nonrecurring and non-routine in nature and are the responsibility of an outside party.

In our previous audit report we identified two situations where the MSU-Bozeman abated expenditures which did not qualify under

Findings and Recommendations

state policy. As part of our current audit, we reviewed 33 expenditure abatements totaling \$40,751 that were recorded on collection reports. Ten of these abatements totaling \$22,282 did not meet the abatement criteria or criteria were applied inconsistently. Since each of the items identified involve situations which occur on a routine basis, the understatement of revenues and expenditures exceeds the \$22,282 noted. By reducing expenditures, these transactions restore budget authority.

During our testing we also noted an employee of the Extension Services was sent to Poland based on an agreement with the United States Department of Agriculture (USDA). USDA reimbursed the university for the salary of this employee during his time in Poland, and provided a 10 percent administrative allowance. The university reduced expenditures rather than recording federal assistance revenue. There were additional trips by this employee and another employee where the same situation occurred resulting in a combined understatement of revenues and expenditures of \$46,554.

MSU-Bozeman personnel stated these abatements occurred because miscommunication and misunderstandings between the Controller's Office and the various academic departments on campus. The university should establish an internal policy on the proper use of expenditure abatements. University personnel provide periodic training to department personnel on accounting issues. By including expenditure abatements in this training, many of the misunderstandings concerning expenditure abatements could be eliminated.

Recommendation #9

We recommend the university:

- A. Record abatements only for those transactions allowed by state policy.
- B. Develop an internal policy on expenditure abatements and provide training on its requirements to all department personnel.

Findings and Recommendations

Expenditure Accruals

State accounting policy allows an agency to accrue expenditures for valid obligations existing at the end of a fiscal year. Policy directs agencies to record the expenditures as an “A” accrual if the item or service is received after June 30, or a “B” accrual if the item or service is received before June 30.

During our review of expenditure accruals recorded for the 1996-97 fiscal year-end period, we noted MSU-Bozeman mistakenly recorded four accrual transactions in the designated subfund totaling \$78,746 as “B” expenditure accruals. The four items included a cargo van and computer equipment and software not received until after June 30, 1997.

Although state law allows "A" accruals in all funds, the university's policy is only to record "A" accruals in the general operating subfund. MSU-Bozeman personnel noted that the controller's office relies on the departments to report only "B" accruals for those non-general operating subfund accounts.

Recommendation #10

We recommend the university accrue expenditure transactions at fiscal year-end in accordance with state accounting policy.

Financial Reporting System Reconciliation

The detailed financial information for grants and contracts at MSU-Bozeman is recorded on its Financial Reporting System (FRS). The MSU-Bozeman, Grants and Contracts Office, prepares federal financial reports and the Schedule of Federal Financial Assistance using the detail information. The FRS is summarized and recorded on the SBAS. MSU-Bozeman Controller's Office personnel complete a reconciliation of the FRS summary information and SBAS at fiscal year-end and make adjustments, if necessary, to the appropriate system. During the audit, we noted the detail and summary information did not agree at fiscal year-end 1995-96 and 1996-97 by a net amount of \$32,836 and \$14,205, respectively. MSU-Bozeman personnel were unable to explain the differences or to demonstrate the federal financial reports and the Schedule of Federal Financial Assistance were supported by SBAS.

Findings and Recommendations

Federal regulations require federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared.

Grants and Contracts Office personnel complete daily reconciliations of the detail and summary information; however, a formal reconciliation is not completed at fiscal year-end. Since payments are made from SBAS, it is important the detail financial information can be reconciled with SBAS. When university grant reports and charges are not supported by or reconcilable to the university's underlying accounting records, federal grantors may impose sanctions. MSU-Bozeman personnel should identify reconciling items at fiscal year-end and ensure any errors are corrected on the respective system.

Recommendation #11

We recommend the university complete a reconciliation of the Financial Reporting System detail and summary financial information at fiscal year-end and resolve any differences.

Grants and Contracts Expenditures

MSU-Bozeman receives funds from federal, state, and private sources for research, public service, and instructional support projects conducted by the university. In fiscal year 1996-97, MSU-Bozeman grants and contracts expenditures were approximately \$36 million, of which \$29 million were charges to federal grants. All accounting transactions pertaining to grants and contracts other than Extension Services and Student Financial Aid are routed through the MSU-Bozeman's Grants and Contracts Office. The Grants and Contracts Office monitors funds spent for projects. Grants and Contracts Office personnel review transactions to ensure costs are approved by appropriate departmental personnel. In addition, personnel review transactions for allowability under federal regulations and the grant agreement prior to processing the transactions for payment. We tested transactions processed through the Grants and Contracts Office and noted the following issues.

Findings and Recommendations

Employee Certification of Time Spent on Grants

Office of Management and Budget (OMB) Circular A-21, requires a payroll distribution system be incorporated into the official records of the institution and reasonably reflect the activity for which the employee is compensated by the institution. The circular requires the method used recognize the principle of after-the-fact confirmation or determination so that costs distributed represent actual costs.

- At MSU-Bozeman, we noted seven instances where employees were paid from various grants. Later, the employees certified the distribution of time spent in a different manner. MSU-Bozeman did not adjust grant charges based on the employee certification report of where their time was spent. When one department was contacted by Grants and Contracts personnel regarding the difference, the certification was adjusted rather than actual payment on SBAS. When we contacted the department, personnel stated they were told to change the certification report. The concern relates to a variety of grants under MSU-Bozeman Grants and Contracts Program. MSU-Bozeman should establish a system to compare employee's certification of actual time spent on grants with charges to grants on SBAS and make appropriate adjustments on SBAS. Failure to base grant charges on accurate and supportable time and effort reports could lead to questioned costs.
- MSU-Bozeman administers two similar grants in two separate locations. We noted one instance where MSU-Bozeman charged payroll of an individual to one of the grants and the associated travel to the other grant. MSU-Bozeman should have allocated both the payroll and travel to the two grants based on the proportionate time and effort spent on each grant.
- At MSU- Northern, we noted two transactions moving a portion of nine employees' salaries and benefits to federal grants. While the total charges are supported, the charges moved are not supported by after-the-fact time and effort reports or another basis for reasonably estimating the allocation of the charges. MSU-Northern personnel stated the salaries and benefits were moved based on budgets in the grant agreements. MSU-Northern should document support for personal service expenditures charged to federal grants in accordance with federal regulations.

Findings and Recommendations

Recommendation #12

We recommend the university establish a system:

- A. To compare employee's certification of actual time spent on grants with charges to grants on SBAS and make appropriate adjustments on SBAS.
- B. That ensures charges to grants are based upon certified time and effort reports at its Northern campus.

Early Pell Grant Disbursements

To minimize interest costs to the federal government, federal regulations require the university to credit financial aid to a student's account no more than ten days before the first day of a semester if the credit is made with federal funds. At MSU-Billings, we sampled 26 student aid files and noted six instances where Pell Grant funds (CFDA #84.063) were disbursed early.

Business office personnel were aware of the federal requirement but stated they miscalculated the number of days. This incorrect calculation was input to the computer system so funds were disbursed to student accounts earlier than federal regulations allow. Funds were disbursed early to students receiving financial aid who paid on the first day of the scheduled fee payment for spring semester 1996. These students' aid was credited to their accounts 13 days before the first day of the semester, three days earlier than allowable under federal regulations.

Recommendation #13

We recommend the university develop procedures to ensure Pell Grant payments are disbursed in accordance with federal regulations.

Independent Auditor's Report & Montana State University-Bozeman Financial Statements

Please obtain a hard copy for opinions and financial statements

Independent Auditor's Report & Montana State University-Billings Financial Statements

Independent Auditor's Report & Montana State University-Northern Financial Statements

Montana State University Response



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March 5, 1998

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
Room 135 State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

I have enclosed Montana State University's response to the Financial-Compliance Audit Report for the two fiscal years ending June 30, 1997. The University concurs with all recommendations and will address them as outlined in our response.

The University appreciates the professional manner in which the audit was conducted and thanks those of your staff involved in the process.

Sincerely,

Michael Malone
President

Enclosure

MONTANA STATE UNIVERSITY
Response to Audit Recommendations
Fiscal Years 1996 & 1997

Recommendation #1

We recommend the university strengthen internal controls by segregating incompatible cash custody and record keeping functions and by instituting additional supervision and review processes.

Montana State University concurs.

Cash controls over the student health service on the Bozeman campus were changed immediately after the problem became apparent. All cash handling operations were subsequently reexamined and are subject to the additional review measures. As mentioned in the audit report, the Northern campus has implemented additional security and review measures for the Great Falls campus.

Recommendation #2

We recommend the university comply with state law regarding deposits and change funds.

Montan State University concurs.

Procedures have been changed to ensure deposits are made in a timely manner and cash change funds noted have been recorded on SBAS.

Recommendation #3

We recommend the university:

- A: Maintain accountability for university assets managed by RDI.
- B: Ensure RDI complies with the contract requirement concerning providing the university with financial statements and a CPA's report verifying their accuracy.

Montana State University concurs with both A and B.

The University will ensure accountability of assets by obtaining the required financial statements and CPA's report verifying their accuracy.

Recommendation #4

We recommend the university formalize all vendor contracts to include the provisions outlined in state policy.

Montana State University concurs.

All future food and beverage contracts will contain the provisions as outlined in state policy.

Recommendation #5

We recommend the university obtain Board of Regents approval, if it is necessary, to allow the bond trustee to hold bond reserves in addition to the \$1.5 million bond indenture requirement.

Montana State University concurs.

The University believes that it is already in compliance with the statute regarding bond reserves on deposit with its trustee. For added clarity, the University will obtain explicit approval from the Board of Regents for deposit of funds with its trustee in excess of the required minimum amount.

Recommendation #6

We recommend the university:

- A: Recover indirect costs to the fullest extent possible in accordance with state law.
- B: Negotiate an indirect cost rate with the federal government.

Montana State University concurs with both A and B.

The Northern campus currently is negotiating an indirect cost rate with the federal government. This rate will be used as the basis for recovering indirect cost to the fullest extent possible.

Recommendation #7

We recommend the university complete grant billings on a timely basis.

Montana State University concurs.

Bozeman's Grants and Contracts Office will continue to monitor billings to ensure that they are submitted in a timely fashion.

Recommendation #8

We recommend the university record transfers on the accounting records and financial statements in accordance with generally accepted accounting principles as required by state law.

Montana State University concurs.

Bozeman's Controllers Office will make every effort to identify transfers on the accounting records and reclassify them during the fiscal year-end period.

Recommendation #9

We recommend the university:

- A: Record abatements only for those transactions allowed by state policy.
- B: Develop an internal policy on expenditure abatements and provide training on its requirements to all department personnel.

Montana State University concurs with both A and B.

Bozeman's Controllers Office will continue to monitor expenditure abatements for compliance with state law and will continue to work with department personnel to ensure compliance.

Recommendation #10

We recommend the university accrue expenditure transactions at fiscal year-end in accordance with state accounting policy.

Montana State University concurs.

Bozeman's Controllers Office will continue to work with and educate department personnel to ensure the proper use of the "B" accrual.

Recommendation #11

We recommend the university complete a reconciliation of the FRS detail and summary financial information at fiscal year-end and resolve any differences.

Montana State University concurs.

Bozeman's Grants and Contracts Office will ensure the reconciliation is completed at fiscal year-end.

Recommendation #12

We recommend the university establish a system:

- A: To compare employee's certification of actual time spent on grants with charges to grants on SBAS and make appropriate adjustments on SBAS.
- B: That ensures charges to grants are based upon certified time and effort reports at its Northern campus.

Montana State University concurs.

Bozeman's Grants and Contracts Office has completed programming changes that informs Grants and Contracts administration as to variances. Grants and Contracts personnel will follow up with the appropriate course of action in a timely manner. Northern will ensure documentation is maintained to support time and effort.

Recommendation #13

We recommend the university develop procedures to ensure Pell Grant payments are disbursed in accordance with federal regulations.

Montana State University concurs.

The Billings campus administration mistakenly used *working days*, rather than *calendar days*, in determining the Pell Grant disbursement date. This has been corrected and resolved.